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No. 89-1893

In the Supreme Court of the United States

OCTOBER TERM, 1990

BELL & MURPHY AND ASSOCIATES, INC.,
ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, ETC.,
ET AL.

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*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT*

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that petitioners may not pursue a claim for relief based on an unrecorded side agreement with a failed bank.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A9) is reported at 879 F.2d 754. The order and judgment of the district court (NCNB Br. in Opp. App. A76-A77) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A10) was entered on February 21, 1990. The petition for a writ of certiorari was filed on May 22, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. When Bell & Murphy and Associates, Inc. (Bell & Murphy), a company engaged in the oil and gas industry, experienced severe financial difficulties in 1985, the company sought assistance from First RepublicBank Dallas (First Republic). Petitioners (Bell & Murphy and four of its employees) allege that, on account of the duress engendered by the company's financial problems, they agreed to a plan proposed by bank officer Charles Jobe. Under Jobe's plan, Bell & Murphy surrendered its accounts receivable and funds from its pension and profit sharing plans to First Republic, and the bank agreed to extend existing corporate loans and to honor certain checking account overdrafts. The agreement allegedly was embodied in a letter signed by Jobe, but neither the letter nor any reference to the agreement was reflected in the bank's books and records. Pet. App. A4.

In April 1988, petitioners filed suit against First Republic and Jobe in Texas state court, alleging that Jobe had coerced them into entering into the agreement through fraudulent misrepresentations and that the bank had breached its obligations under the terms of the agreement. In July 1988, First Republic was declared insolvent by the Comptroller of the Currency and respondent Federal Deposit Insurance Corporation was appointed receiver. Respondent NCNB Texas National Bank was then selected by the FDIC to serve as the manager of the "bridge bank" and thus to acquire a portion of the assets and liabilities of the failed bank. Pet. App. A4.

The FDIC and NCNB subsequently intervened as defendants in petitioners' action against First Republic and removed it to federal district court. The

defendants then moved to dismiss the action, arguing that, under *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), petitioners are barred from asserting any claims arising out of First Republic's alleged secret promise to make future loans. The district court agreed and dismissed the action for failure to state a claim. NCNB Br. in Opp. App. 76-77.

2. The court of appeals affirmed, also relying on *D'Oench, Duhme*. In that case, the court of appeals explained, "the Court fashioned a common law rule of estoppel precluding a borrower from asserting against the FDIC defenses based upon secret or unrecorded 'side agreements' that altered the terms of facially unqualified obligations." Pet. App. A5.[1] The purpose of the rule against the enforcement of side agreements is " 'to protect . . . [the FDIC] and the public funds which it administers, against misrepresentations as to . . . the assets in the portfolios

[1] The result in that case, the court noted, was "later ratified" by Congress when it enacted 12 U.S.C. 1823(e). Section 1823(e) provides that "[n]o agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it * * * shall be valid against the Corporation unless such agreement (1) is in writing, (2) was executed * * * contemporaneously with the acquisition of the asset by the depository institution, (3) was approved by the board of directors of the depository institution or its loan committee * * *, and (4) has been, continuously, from the time of its execution, an official record of the depository institution." Financial Institutions Reform, and Enforcement Act of 1989, Pub. L. No. 101-73, § 217, 103 Stat. 256. The court added that, prior to the 1989 amendment of Section 1823(e), the FDIC could not "rely upon the enumerated requirements of section 1823(e) where, as here, it acts as receiver rather than in its corporate capacity." Pet. App. A6. The court stated that the FDIC "is nonetheless entitled to the protection of the common law *D'Oench, Duhme* rule." *Ibid.*

of the banks which . . . [the FDIC] insures or to which it makes loans.'" *Ibid.* (quoting 315 U.S. at 457). The court of appeals accordingly recognized that, since petitioners allege that they sustained damages in connection with an unrecorded side agreement, their claim is barred under *D'Oench, Duhme* in the absence of an exception to its rule against enforcing unrecorded side agreements. The court held, contrary to petitioners' contentions, that no differences between this case and *D'Oench, Duhme* justify the creation of an exception here.

The court first rejected petitioners' claim that this case is distinguishable because no "specific asset" of the FDIC was diminished in value as a result of their claim. In *D'Oench, Duhme*, the FDIC sought to collect on a note that it had obtained from a bank, and the defendant resisted on the ground that the bank had secretly agreed never to enforce the note; thus, a specific asset (the note) would have had no value under the side agreement. Here, petitioners contend, there is no specific asset that would be diminished in value—although the total value of the bank's assets would, of course, be diminished to the extent that petitioners collect on their claims—and that *D'Oench, Duhme* is distinguishable on that ground. The court of appeals held "this inventive argument to be meritless in light of our recent holding in *Beighley* [v. *FDIC*, 868 F.2d 776 (5th Cir. 1989),] that the *D'Oench, Duhme* rule bars affirmative claims based upon unrecorded agreements to extend future loans." Pet. App. A6-A7. The court explained that the reason for the holding in *D'Oench, Duhme* was that bank examiners must be able to ascertain a bank's assets from its records. Since the agreement on which petitioners base their claims

"was not contained in Republic's records, * * * it could not have been discovered by bank examiners and is not enforceable against the FDIC." *Id.* at A7.

The court of appeals next rejected petitioners' argument "that the *D'Oench, Duhme* rule bars only claims or defenses based upon *illegal* side agreements entered into for the purpose of deceiving banking authorities." Pet. App. A7. The court noted that although the obligor in *D'Oench, Duhme* was a knowing participant in a fraudulent scheme, this Court stated that even a borrower who was "very ignorant and ill-informed of the transaction" and did not "intend[] to deceive any person" would be precluded from relying on unrecorded side agreements. *Ibid.* (quoting 315 U.S. at 458-459). Relying on *Langley* v. *FDIC*, 484 U.S. 86, 94 (1987), the court of appeals concluded that "[t]he *D'Oench, Duhme* doctrine * * * favors the interests of depositors and creditors of a failed bank, who cannot protect themselves from secret agreements, over the interests of borrowers, who can." Pet. App. A7. Because petitioners could have protected themselves by insisting that the bank properly record the alleged side agreements, but did not, the court of appeals held that petitioners are estopped from asserting any claim arising out of the secret agreement. *Id.* at A7-A8.

The court of appeals also rejected petitioners' claim that they may enforce the unrecorded agreement under *Howell* v. *Continental Credit Corp.*, 655 F.2d 743 (7th Cir. 1981), because it was a valid "bilateral agreement." The court noted that *Howell* involved a "properly recorded agreement," while "the alleged bilateral agreement which [petitioners]

seek[] to enforce against the FDIC is unrecorded." Pet. App. A8, A9.[2]

ARGUMENT

The decision below is correct and does not conflict with any decision of this Court or another court of appeals. Review by this Court is particularly unwarranted on account of the 1989 amendments to the national banking laws, which confirm that unrecorded side agreements are not enforceable.

1. The court of appeals applied *D'Oench, Duhme* in a straightforward manner, and correctly concluded that its rule is applicable in this case because the alleged agreement that petitioners seek to enforce was never recorded in the bank's books and records. Petitioners suggest, almost in passing, that the court of appeals erred in distinguishing this case from *Howell* on the basis that the agreement in that case had been recorded, alleging that the evidence here did not show that the agreement was unrecorded. Pet. 27. But the court of appeals found that the agreement "was not contained in Republic's records" (Pet. App. A7) and the district court like-

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[2] In addition, the court held, relying on *FSLIC* v. *Murray*, 853 F.2d 1251 (5th Cir. 1988), that petitioners may not pursue their claim against NCNB because, as a bridge bank, it is entitled to holder-in-due-course status. The court explained that "failure to extend *D'Oench, Duhme's* protection to bridge banks would undermine the effectiveness of bridge banks as a means of continuing the normal banking operations, and thereby protecting the depositors and creditors, of a failed bank." Pet. App. A9. Petitioners have not challenged that holding. Nor did they appeal from the district court's judgment in favor of Jobe, the bank officer who allegedly fraudulently induced them to enter into the agreement. *Id.* at A4 n.2.

wise dismissed on the basis of *D'Oench, Duhme* (NCNB Br. in Opp. App. A76-A77). There is no warrant for this Court to reconsider the factual findings of the two lower courts.

Petitioners primarily renew their contention (Pet. 12-21), which the court of appeals termed "inventive" (Pet. App. A6), that the rule against the enforcement of unrecorded side agreements should not be applied in this case because no "specific asset" (but, instead, the failed bank's total assets) would be affected. As the court of appeals held, petitioner's alleged distinction makes no sense. The essence of the holding in *D'Oench, Duhme* is that a person dealing with an institution insured by the FDIC may not assert a claim or defense against the FDIC based upon an unrecorded side agreement with a failed bank because the agreement may have had the effect of deceiving the banking authorities, and there is no reason why it should matter whether the side agreement compromises specific assets or the total assets of a failed bank. As this Court recognized in *Langley*, bank examiners must be able "to rely on a bank's records in evaluating the worth of the bank's assets," and when evaluating a failing bank they must make decisions "with great speed." 484 U.S. at 91. There is no room in this process for the enforcement of secret agreements. Accordingly, no court has held that there is merit to the distinction petitioner suggests. To the contrary, as the court of appeals stated (Pet. App. A6-A7), the court in *Beighley* specifically held that "affirmative claims based upon unrecorded agreements to extend future loans" are barred.

Petitioners also contend (Pet. 21-27) that their side agreement should be enforceable in the absence of a showing that they were at fault, by which they mean that they affirmatively intended to deceive bank

examiners or negligently entered into such a scheme. Whether someone intended to deceive banking authorities is not, however, the relevant inquiry. To the contrary, what matters is whether the unrecorded agreement could have had the effect of misleading other borrowers or bank examiners, as the court of appeals concluded. By failing to ensure that the agreement was recorded, Bell & Murphy "lent [itself] to a *scheme or arrangement* whereby the banking authority . . . was likely to be misled." *Langley*, 484 U.S. at 92 (quoting *D'Oench*, *Duhme*, 315 U.S. at 460).[3]

2. In any event, review is not warranted because of changes in the banking laws enacted by Congress through the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183. As the court of appeals noted (see Pet. App. A6 and note 1, *supra*), prior to 1989, 12 U.S.C. 1823(e) applied only when the FDIC was acting in its corporate capacity and not when it is

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[3] Petitioners allege (Pet. 21) a conflict with *FDIC* v. *Meo*, 505 F.2d 790, 793 (9th Cir. 1974), where a defendant who was "innocent of any wrongdoing or negligence" was not barred from asserting a defense in an action by the FDIC to collect on a note. However, that case is very different from this case. In *Meo*, the defendant gave the bank the note in return for shares of the bank's common stock, but the bank failed to issue common stock to the defendant. When the FDIC subsequently sought to enforce the note, the court allowed the defendant to assert failure of consideration as a defense. While the court's decision contains broad language, it has never been applied to permit anyone to pursue a claim based on an unrecorded side agreement. To the contrary, the Ninth Circuit has construed *Meo* narrowly. See *FDIC* v. *Bank of San Francisco*, 817 F.2d 1395, 1398-1399 (1987); *FDIC* v. *First Nat'l Finance Co.*, 587 F.2d 1009, 1011-1012 (1978).

acting as a receiver. But Section 1823(e) was amended in 1989 to apply as well when, as here, the FDIC is acting "as receiver of any insured depository institution." In addition, Congress added 12 U.S.C. 1821(d)(9)(A), which states that "any agreement which does not meet the requirements set forth in section 1823(e) of this title shall not form the basis of, or substantially comprise, a claim aaginst the receiver or the Corporation."[4] § 212, 103 Stat. 231.

Petitioners acknowledged in the court of appeals that the side agreement they seek to enforce "might not meet all the requirements of § 1823(e)." NCNB Br. in Opp. App. A108. Indeed, of the four requirements set forth in that provision (see note 1, *supra*), the agreement appears only to satisfy the requirement that it be "in writing." The side agreement plainly fails to meet the fourth requirement of Section 1823(e)—that the agreement "has been, continuously, from the time of its execution, an official record of the depository institution." Accordingly, in the future there will be no question that claims such as those brought by petitioners are barred.

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[4] In addition, Congress added 12 U.S.C. 1821(n)(4)(I), which expressly extends the same protections to bridge banks. § 214, 103 Stat. 249.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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